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New Regulations Permit Late Section 179 Election

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New Regulations Permit Late Section 179 Election

— by Neil E. Harl*

In claiming expense method depreciation under I.R.C. § 179, the rule has been that the election had to be made on the original return (whether or not timely filed) or on an amended return, and then only if filed within the time for filing a return (including extensions) for the taxable year.¹ In a surprise move, new regulations, effective August 4, 2004, allow a late I.R.C. § 179 election on an amended return for property placed in service after 2002 and before 2006.²

The 2003 Act

Prior to the 2003 tax act, the Jobs and Growth Tax Relief Reconciliation Act of 2003,³ an election to claim expense method depreciation could be revoked only with IRS consent and consents were to be granted “only in extraordinary circumstances.”⁴

Under the 2003 tax act,⁵ expense method depreciation elections can be revoked (with respect to any taxable year beginning after 2002 and before 2006) by the taxpayer with respect to any property without IRS consent.⁶ The revocation, once made, is irrevocable.⁷ Note that the opportunity to revoke without IRS consent is only available for 2003 through 2005 years.⁸

The Committee Report on the 2003 Act⁹ indicated that taxpayers could make an expense method depreciation election on an amended return *but that language was not reflected in the statute* as amended in 2003.¹⁰

Now, IRS has embraced the committee report language and, effective August 4, 2004, will allow late elections on an amended return.¹¹ The relevant passage in the new regulations states:

“For any taxable year beginning after 2002 and before 2006, a taxpayer is permitted to make an election under section 179 on an amended Federal tax return for that taxable year without the consent of the Commissioner. Thus, the election under section 179 and § 1.179-1 to claim a section 179 expense deduction for section 179 property may be made on an amended Federal tax return for the taxable year to which the election applies. The amended Federal tax return must include the adjustment to taxable income for the section 179 election and any collateral adjustments to taxable income or to the tax liability (for example, the amount of depreciation allowed or allowable in that taxable year for the item of section 179 property to which the election pertains). Such adjustments must also be made on amended Federal tax returns for any affected succeeding taxable years.”¹²

Thus, the new regulations go beyond the statute.¹³ It is unusual, but not unprecedented,

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for the Internal Revenue Service to depart from the statute in drafting regulations.¹⁴

Required specification of items

The new regulations also make even more explicit than previous guidance that the amended election (and elections) must specify the items of I.R.C. § 179 property and the portion of cost of each item to be taken into account.¹⁵ The taxpayer is required to make other appropriate adjustments to the depreciation computations for the current, preceding and succeeding taxable years.¹⁶

Change applies only to 2003, 2004 and 2005

It is important to note that the change, effective August 4, 2004, only applies to tax years beginning in 2003, 2004 and 2005¹⁷ If no further change is made, the state of the law reverts to the former requirement that I.R.C. § 179 elections must be made on the original return or on an amended return filed within the time for filing the original return (with extensions) for the taxable year.¹⁸ The years allowing an election on an amended return are the years in which the enhanced expense method depreciation amount on an inflation-adjusted basis has been increased to \$100,000 for 2003, \$102,000 for 2004 and \$100,000 plus an inflation adjustment for 2005.¹⁹

Importance of this development

Particularly in light of the magnitude of the potential deduction, this development takes on considerable tax planning significance. Audit challenges of repair items may be met with a late election to claim expense method depreciation, assuming the I.R.C. § 179 amount had not previously been used. Likewise, the development adds another option to challenges as to the timing in reporting income items. Also, any deficiencies in the original Section 179 election are less likely to be fatal because of the opportunity for an amendment to be made.

FOOTNOTES

¹ Treas. Reg. § 1.179-5(a). *Patton v. Comm'r*, 116 T.C. 206 (2001) (self-employed welder could not revoke, amend or modify I.R.C. § 179 election after time had expired for filing return for

taxable year in question); *McGrath v. Comm'r*, T.C. Memo 2002-231, *aff'd*, 2003-2 U.S. Tax Cas. ¶ 50,663 (5th Cir. 2003) (failed to make election on return and too late for amended return; involved cost of improvements to retail space). See generally, 4 Harl, *Agricultural Law* § 29.05[2][b][v] (2004); Harl, *Agricultural Law Manual* § 4.03[4][j].

² 69 Fed. Reg. 46982 (Aug. 4, 2004), T.D. 9146, promulgating Temp. Treas. Reg. § 1.179-5T(c).

³ Pub. L. No. 108-27, 117 Stat. 757 (2003).

⁴ Treas. Reg. § 1.179-5(b). See *King v. Comm'r*, T.C. Memo. 1990-548 (taxpayer may not later substitute other property for expense method depreciation property without revoking election).

⁵ Pub. L. No. 108-27, Sec. 202, 117 Stat. 757 (2003).

⁶ *Id.*

⁷ I.R.C. § 179(c)(2).

⁸ *Id.*

⁹ H.R. Conf. Rep. No. 108-126, p. 35 (2003).

¹⁰ I.R.C. § 179(c)(1). See Treas. Reg. § 1.179-5(a).

¹¹ Temp. Treas. Reg. § 1.179-5T(c)(2)(i).

¹² *Id.*

¹³ I.R.C. § 179(c)(1)(B).

¹⁴ See, e.g., Treas. Reg. § 1.451-6, which disregarded statutory language in I.R.C. § 451(d) on election to defer taxability of crop insurance proceeds and disaster payments.

¹⁵ Temp. Treas. Reg. § 1.179-5T(c)(2)(ii).

¹⁶ Temp. Treas. Reg. § 1.179-5T(c)(2)(i).

¹⁷ Temp. Treas. Reg. § 1.179-5T(c).

¹⁸ Treas. Reg. § 1.179-5(a).

¹⁹ I.R.C. § 179(b), amended by Pub. L. No. 104-188, Sec. 1111(a), 117 Stat. 757 (2003).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

GENERAL

EXEMPTIONS

HOMESTEAD. The debtor owned a 161 acre tract which was formerly used to graze cattle but was enrolled in the Conservation Reserve Program at the time of bankruptcy filing and was otherwise used only for hunting. The debtor's residence was located on a five acre tract about five miles from the CRP land. The debtor had entered into a contract to sell the CRP land pre-petition but the sale was not closed. The debtor claimed both tracts of land as exempt homestead

property. A creditor objected to the exemption, arguing that the enrollment in the CRP and the contract for sale excluded the property from homestead status. The court held that both tracts were eligible for the homestead exemption in that the CRP did not preclude all other farm/homestead uses of the land and Texas law allowed an exemption for the proceeds of the sale of a homestead for six months after the sale. ***In re Baker*, 307 B.R. 860 (Bankr. N.D. Texas 2004).**

FEDERAL TAX

DISCHARGE. The debtor failed to timely file and pay taxes for 1990 and the IRS constructed a substitute return in 1995 and filed a notice of deficiency in 1997. The debtor